In the Supreme Court of the United States

OCTOBER TERM, 1975

No. 75-92

ROBERT W. TUNNELL and EOLYNE K. TUNNELL,
PETITIONERS

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE THIRD CIRCUIT

MEMORANDUM FOR THE UNITED STATES IN OPPOSITION

The sole question presented in this federal income tax case involves the correct basis for depreciation of canals ("lagoons") dredged by petitioners in connection with their development of two mobile home trailer parks.

These lagoons were used for boat access and mooring and were created for the additional purpose of acquiring fill dirt for converting low-lying marsh-

lands into useable land areas. The district court held that petitioners' entire cost of dredging (about $105,000) should be treated as the depreciable basis of the lagoons (Pet. App. A1-A6). The court of appeals vacated and remanded the case to the district court for further evidence concerning the useful lives of the lagoons (Pet. App. A21-A27). However, it upheld the Commissioner's position that the depreciable cost of the lagoons was the excess of the cost of construction over the market value of the fill dirt (*id.* at A24-A25).

1. Petitioners argue (Pet. 8-9) that the decision of the court of appeals is inconsistent with what they claim to be the uniform administrative practice to apportion the lump-sum cost of two assets on the basis of their respective fair market values. But the rule which they invoke was developed to deal with the different case where two separate assets are purchased for an unallocated lump-sum price, where the assets could have been acquired separately, and where it is apparent that only a part of the lump price is being paid for each of the assets. There, the problem is one of determining what part of the total price is allocable to the cost of each separate asset. As a result, where the allocation is of a negotiated purchase price, it is appropriate to allocate the bases in proportion to the market values of the assets because it can be reasonably assumed that the total price is the sum of the respective market values.

However, this approach is not applicable to this case where the cost of the assets is not derived from a negotiated purchase price but from fixed costs incurred in creating the assets which are unrelated to value. Thus, since petitioners' costs in dredging the lagoons produced two assets—the lagoons and the fill dirt—the value of the fill should be subtracted from the total cost to yield the correct basis of the lagoons.[1]

Indeed, the allocation rule urged by petitioners would conflict with the basic principles of tax depreciation established by this Court in *Massey Motors* v. *United States*, 364 U.S. 92, 107, and in *United States* v. *Ludey*, 274 U.S. 295, 300-301. There, the Court observed that the only purpose of the depreciation deduction is to allow the taxpayer to recover, in the aggregate, an amount which, when added to the salvage value (the amount which can be recovered through resale of the asset), will equal the taxpayer's original cost of acquiring or creating the asset. See also Treasury Regulations, Section 1.167 (a)-1(a). In determining the proper basis for depreciation of the lagoons, the fill has the same relationship to the depreciable property as salvage value, and accordingly must be deducted.

The further admonition in *Massey Motors* (364 U.S. at 101) that "Congress intended by the depreci-

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[1] Treasury Regulations, Section 1.167(a)-5 cited by petitioners (Pet. 8), deals only with the distinguishable case of the lump-sum acquisition of two assets which could have been acquired and priced separately. To the same effect are the two Tax Court memorandum decisions and the revenue ruling relied upon by petitioners (*ibid.*).

ation allowance not to make taxpayers a profit thereby, but merely to protect them from a loss" has pointed application here. As the court of appeals recognized (Pet. App. A24), the fill created additional value in the reclaimed marshland which could be recovered at any time. Thus, if petitioners were permitted to ignore the enhanced value generated by the land fill and to depreciate the entire cost of constructing the lagoons, they would be able to recover a sum in excess of that cost and thereby make an unwarranted profit from their depreciation.

2. Petitioners further argue (Pet. 10-11) that the value of the dirt fill must be measured as of the end of the 20-year useful life of the lagoons. However, their contention is premised upon an incorrect characterization of the decision below as requiring that the fill dirt be treated as the salvage value of the lagoons. The court of appeals held that petitioners' actual cost of acquiring the lagoons was not more than the excess of the total outlay over that part which was reflected in the increased, and nonwasting, value created in the land by the same dredging costs. Thus, the improvements to the marshlands created through the use of the fill dirt was treated as increasing the salvage value of the land and not the lagoons.[2]

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[2] Moreover, petitioners cannot complain (Pet. 10) properly that the court of appeals permitted an alternative use of the cost of obtaining the required amount of fill dirt from some other source. This accomodation was for petitioners' benefit and was a recognition of the possibility that the quantity

It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

ROBERT H. BORK,
Solicitor General.

SEPTEMBER 1975.

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and quality of fill dirt required to effect the improvements to the marshy land areas could have been purchased elsewhere at a lesser cost than dredging their own land, so that only the lesser amount should be deducted from the portion of the dredging costs assigned as the depreciable basis of the lagoons.

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